IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1940

No. .....

DOROTHY E. ROETTER,

Petitioner,

vs.

FRANK M. McKEY, TRUSTEE OF THE ESTATE OF BURT LEOPOLD ROETTER, BANKRUPT,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinion Below.

The opinion of the Circuit Court of Appeals for the Seventh Circuit in this case is presented in full in the record herein (R. 179-183).

II.

Jurisdiction.

The basis of jurisdiction is stated on Page 6 of the Petition for the Writ of Certiorari, and in the interest of brevity is not repeated.

III.

Statement of the Case.

A statement of the case, so far as the same is material to the questions presented, appears on Pages 1-6, incl. of the Petition for the Writ of Certiorari, under the caption of "Summary Statement of the Matter Involved," and is not, therefore, repeated here.

IV.

Specifications of Errors.

The Circuit Court of Appeals erred:

1. In holding that it was not incumbent upon the respondent (plaintiff below) to prove that the petitioner, as the transferee of said securities, knowingly participated with the bankrupt in an actual intent to defraud his creditors.

2. (a) In holding that said transfers of securities herein occurred at a time when the bankrupt was indebted in excess of his assets.

(b) In holding that it was sufficient if the bankrupt's liability as a shareholder of the closed bank was established subsequent to the transfers of property in issue.

(c) In holding that the bankrupt had creditors to whom he was indebted, and that he was insolvent when the said transfers occurred.

3. In holding that the transfers of the securities herein from the bankrupt to the petitioner were voluntary.

4. In holding that said transfers of securities must be conclusively presumed fraudulent as a matter of law, with-

out regard to the actual intention of the petitioner or the bankrupt.

5. In holding that the delivery of said securities by the bankrupt to the petitioner occurred in May, 1934, when the proof showed a constructive delivery long before this date.

6. In reversing the decree without remanding the cause for re-trial and thus depriving the petitioner of the right to offer evidence in support of her defense, as provided in Rule 41(b) of the Rules of Civil Procedure for the District Courts of the United States, and in thus depriving her of her constitutional right of "due process of law" as guaranteed by the Federal Constitution.

7. In reversing the decree of the District Court of the United States.

V.

Summary of Argument.

1. In a plenary suit against the wife of a bankrupt to set aside a transfer of property by the bankrupt to her, as in fraud of creditors, proof of actual fraud must be shown *as to her* where the issue as made by the pleadings is one of actual fraud.

2. (a) The transfer is not fraudulent where no existing indebtedness at the time of the transfer is shown.

(b) The transfer is not fraudulent as to *subsequent* creditors where it is not shown that the wife held or holds the property as a secret trustee of the bankrupt.

(c) Whether the existence of an unliquidated liability on the bankrupt's part for debts of a closed bank constituted a "debt" within the meaning of the Bankruptcy Act, under which jurisdiction in the plenary suit was invoked, is a novel question.

3. Whether the transfers of property herein were voluntary or based on a good and valuable consideration is a novel question.

4. Presumption of fraud in case of voluntary transfer by failing husband to his wife is one of fact and not of law.

5. The retention of possession by a husband of property transferred to his wife, and his exercise of control thereof, is not inconsistent with her claim of a valid delivery to and ownership thereof by her.

6. Under Rule 41(b) a defendant whose motion to dismiss the Complaint at close of plaintiff's case is allowed, and which the revieiwing court holds should have been denied, should, upon reversal of cause, be given chance to present defense. Otherwise, right to make such motions is virtually destroyed. In any event, the rule should be construed in interest of clarity and for protection of "due process" rights under Federal Constitution.

VI.

Argument.

1. As made by the pleadings, the issue herein was whether the petitioner was knowingly a party to an actual intent to defraud the bankrupt's creditors (R. 2-15).

In *Albers* v. *Smiley,* 300 Ill. App. 66, a proceeding to set aside a conveyance from a father to his daughter (Mrs. Bechly), as in fraud of creditors, a decree granting the relief was reversed, the Appellate Court saying (Page 72):

> "There is another feature of the case on which the plaintiff wholly failed, and that is to establish any fraud on the part of Mrs. Bechly. There is no evidence whatsoever, that she knew that her father was indebted to the bank at the time the transactions were made * * *"

And in *Ayers Nat. Bank* v. *Barber*, 287 Ill. 182, which was a suit to set aside a conveyance from husband to wife, as in fraud of creditors, the Court said (Pages 187, 188):

> "We have examined the evidence with great care, and our conclusion therefrom is that plaintiffs in error failed to establish by any evidence in the record their right to any equitable relief against Anna M. Barber. *While the evidence does prove clearly an intent on the part of William Barber by means of said conveyance to hinder, delay and to defraud the plaintiffs in error in the collection of their judgment, Mrs. Barber was not shown to have participated in the fraudulent intent.*" (Italics ours.)

That proof of participation by the transferee in an *actual* fraud is essential in a suit to set aside an allegedly fraudulent transfer was also held in *Marshall* v. *Gelfand*, 99 Fed. (2d) 85. In the *Marshall* case, wherein Gelfand, trustee in bankruptcy, sought to set aside a transfer of property from the bankrupt to his wife on the ground of fraud, the Court, in refusing relief, said (Page 86, 87):

> "The charge is one of fraud and we do not think it was supported by the unequivocal and convincing evidence which the law requires. * * *
>
> "As to the stock transfer there is little or nothing from which to infer fraud. Mrs. Marshall testified that she never supposed he was insolvent until he filed his petition in bankruptcy. This is credible because he was careful in business and only one claim was filed against his estate."

2. (a) The opinion of the Circuit Court of Appeals that the bankrupt was indebted when the transfers of property took place conflicts with the established rule in Illinois.

In *Bittinger* v. *Kasten*, 111 Ill. 260, it was alleged that Kasten, surety on an appeal bond, conveyed his property to his wife while a suit to enforce his liability as such surety was pending against him, and that the conveyance was therefore fraudulent. In affirming the decree below, dismissing the suit for want of equity, the Illinois Supreme Court said (Page 264):

> "There is neither allegation nor proof of the insolvency of Kasten at the time of his conveyance to his wife. It is neither alleged nor proved that at that time he owed any debts whatever, or had any liability other than that upon the appeal bond in question. * * *"

And in *Mundell* v. *Craven*, 267 Ill. App. 446, a comparatively recent decision, it was said of the liability of a bank stockholder (Page 451):

> "It is a liability imposed upon a stockholder not for his own debt but for the debts and liabilities of the bank."

A very recent case (decided in 1937), clearly defining the rule in Illinois applicable to voluntary transfers (assuming for the sake of argument that the transfers herein were voluntary), is *Knowles* v. *Crow*, 289 Ill. App. 108, wherein the Illinois Appellate Court affirmed a decree dismissing a creditor's bill for want of equity, and said (Pages 112-113):

> "The law is well settled that no creditor has any right, in the absence of a lien, to complain that his debtor is giving away his property to his wife or children unless such creditor can establish the fact that the debtor has not retained sufficient property to satisfy *existing debts*. *State Bank of Clinton* v, *Barnett*, 250 Ill. 312. Where there is no actual fraud it is essential that the creditor allege and prove that the

donor was insolvent at the time the conveyance was made. * * *

"Applying these principles to the bill in this case we find no theory upon which it may be maintained that the transfer of real estate alleged in the bill constituted a fraud upon creditors. There is no allegation of the financial condition of the grantor at the time this transfer was made. *There is not any indication of the indebtedness of George A. Crow in addition to that owed complainant.* * * *"

(b) The rule that a transfer of property may be shown to be fraudulent as to *subsequent* creditors, applies only where a trust for the transferor's benefit is shown to exist. In *Wojtas* v. *Rachel,* 267 Ill. App. 148, where such trust *was* proved, it was said (Page 157):

"It is also urged that the defendant in error had no right to complain of any conveyances of property made by Peter Rachel unless at the time of conveyance he was a creditor of Peter Rachel. While it is true that the owner of property may at any time give the same to anyone he chooses, so long as he thereby injures no then existing creditor, and no subsequent creditor can call it in question, unless the donor is guilty of an actual intent, and such creditor is thereby injured (*Bittinger* v. *Kasten,* 111 Ill. 260; *Chicago Daily News Co.* v. *Siegel,* 212 Ill. 617), nevertheless under the evidence in the instant case, we are of the opinion this claim is not sustainable, as a conveyance by a debtor to another in trust for him, may be assailed by future as well as existing creditors."

In *Jones* v. *King,* 86 Ill. 225, cited in the *Wojtas* case, the Court said (Page 229):

"We understand the rule to be settled, that where the conveyance is colorable merely, *and a secret trust*

> *and confidence exists for the benefit of the grantor,* the conveyance will be held void both as against precedent and subsequent creditors." (Italics ours.)

In *National City Bank* v. *Cowdin,* 343 Ill. 430, the Illinois Supreme Court reversed a decree setting aside a conveyance from husband to wife, saying (Page 434):

> "No presumption of an intent to defraud *subsequent* creditors arises from the mere fact that a husband engaged in business enterprises makes a conveyance to his wife. * * *" (Italics ours.)

And in the case of *Anderson* v. *Hultberg,* 247 Fed. 273, the Circuit Court of Appeals for the 8th Circuit, announced the following rule (Page 277):

> "It is indispensable to the maintenance of a suit on a creditor's bill to avoid conveyances made or caused by the debtor before the judgment on which the creditor's suit is founded was rendered against the grantor as in fraud of the latter's creditors that the plaintiff prove the existence, at the times the conveyances were respectively made, of the trust, the indebtedness, or the actual fraudulent intent of the judgment debtor on which plaintiff relies."

It is true, as the opinion of the Court of Appeals herein says, that the liability of a stockholder of a bank is contractual, primary and absolute, and attaches when the stock is purchased. (See Opinion, Rec. 235.) The same can be said of the liability of the surety on the appeal bond in the case of *Bittinger* v. *Kasten,* 111 Ill. 260, cited above. *Nevertheless, such liability was not held therein to be an indebtedness when the conveyance was made.*

Finally, the opinion of the Court of Appeals is likewise in conflict, on the question under discussion, with the

decision of this Honorable Court in the case of *Horbach v. Hill*, 112 U. S. 144, wherein Mr. Justice Field said (Page 149):

> "Even a voluntary conveyance is good as against subsequent creditors unless executed as a cover for future schemes of fraud."

(c) Moreover, whether the plaintiffs in the suit to establish the bankrupt's liability as a stockholder of the closed bank were creditors of the bankrupt within the meaning and intent of the Bankruptcy Act (under which Act the respondent invoked jurisdiction in the plenary suit) before such liability was reduced to judgment or otherwise liquidated or established, raises a question not previously decided by any Federal Court.

In this connection the petitioner desires to draw attention to what she believes to be the pertinent provisions of the Bankruptcy Act.

Section 1, Paragraph 11 of said Act, defines a creditor as follows:

> "(11) 'Creditor' shall include anyone who owns a debt, demand or claim provable in bankruptcy, and may include his duly authorized agent, attorney or proxy."

Section 57, Paragraph (d), provides in part:

> "That an unliquidated or contingent claim shall not be allowed unless liquidated or the amount thereof estimated in the manner and within the time directed by the Court; and such claim shall not be allowed if the Court shall determine that it is not capable of liquidation or of reasonable estimation, or that such liquidation or estimation would unduly delay the administration of the estate or any proceeding under this Act."

Whether in the light of the above quoted provisions of the Bankruptcy Act the creditors of the bank, who numbered some thirty-two thousand (R. 226), were creditors of the bankrupt at the time of the transfers of property herein and before the bankrupt's liability as a stockholder of the bank was determined; and whether such a large number of creditors could have had their claims liquidated and allowed without undue delay "of the administration of the estate" or any proceeding under the Bankruptcy Act, are questions of sufficient public importance to be decided by this Honorable Court.

3. The question as to whether the transfers of property made in the circumstances disclosed herein (See Summary Statement, Pages 3-4) were voluntary or, as the petitioner contended below, were based upon a good and valuable consideration, is a novel one.

The cases of *Harting* v. *Jockers,* 136 Ill. 627, and *Moore* v. *Wood,* 100 Ill. 451, relied on by the opinion of the Circuit Court of Appeals to support the finding that the transfers herein were voluntary (R. 182), are not in point and not decisive of the question herein because in both these cases the proof showed that the purpose of the property transfers was to create a secret trust for the grantor's benefit. No such purpose was disclosed, nor does the opinion of the Circuit Court of Appeals find that any such trust was created, in the case at bar. Moreover, the *Harting* case characterized a transfer of property made in consideration of future support as being one based upon a *valuable consideration, even where made for the grantor's benefit.* In any event, the legal character of the agreement between the bankrupt and his wife in the case at bar has never previously been decided in Illinois, nor by this Honorable Court, and the petitioner believes it to be of sufficient public importance to be determined by this Honorable Court.

4. The opinion of the Circuit Court of Appeals that the transactions between the bankrupt and the petitioner

herein were fraudulent as a conclusive presumption of law conflicts with this same Court's decision in *Weld* v. *McKay*, 218 Fed. 807, wherein it was said (Pages 809-810):

> "It is also urged that (conceding this court will not disturb the findings of fact of the trial court) a question of law is involved; that under the law of Illinois there is a presumption of law against the validity of transfers from husband to wife, where the husband is in failing circumstances. Here, too, counsel are in error. It is lawful in Illinois and elsewhere (save as prohibited by the Bankruptcy Law), for a failing debtor to prefer one or more of his creditors to the exclusion of the others. It is also lawful for a husband to prefer his wife as a creditor, in the absence of fraud, actual or constructive to which she was a party. Such transactions, it is true are subject to the keenest scrutiny, but they are not *ipso facto* illegal.
>
> "*There is perhaps, a presumption against the bona fides of a conveyance made by a failing husband to his wife; but it is merely a presumption of fact, negativing the idea of a valid consideration.* * * *" (Italics ours.)

The Illinois cases are to the same or similar effect. In *McKennan* v. *Mickelberry*, 242 Ill. 117, the rule with respect to fraud is laid down as follows (Page 134):

> "It has been repeatedly laid down by this and other authorities that fraud will not be presumed, but must be proved, like any other fact, by clear and convincing evidence. (*Union Nat. Bank* v. *State Nat. Bank*, 168 Ill. 256, and authorities cited). * * * If the motives and designs of the parties charged with fraud or collusion may be traced to an honest and legitimate source equally as to a corrupt one, the former explanation ought to be preferred. (*McConnell* v. *Wilcox*, 1 Scam. 344.) Fraud is never presumed when transac-

tions may be fairly reconciled with honesty, and if the weight of the evidence is in favor of an honest motive that conclusion should always be adopted."

In *Mitchell* v. *Fahler,* 210 Ill. App. 516, wherein a decree setting aside an allegedly fraudulent conveyance from husband to wife was reversed, the Appellate Court said (Pages 517, 518):

"A conveyance from husband to wife will be legally upheld when there is no attempt to defraud creditors, and it is equitable and just that the title should be placed in the wife at the time of the conveyance even though the husband afterwards becomes insolvent. *Behrens* v. *Steidley,* 198 Ill. 303. A voluntary conveyance to a wife may be sustained as against creditors, unless the circumstances attending the conveyance justly create a presumption of fraud actual or constructive."

And in *Kingman* v. *Mowry,* 182 Ill. 256, where a transfer of property from a debtor to a subsequently formed corporation was under attack, the Illinois Supreme Court which upheld the validity of the transaction said (Page 261):

"The contention of appellant is, the transfer by a debtor of his property to a corporation necessarily hinders and delays the creditor in the collection of his debts, and is in all instances a fraud, in legal contemplation. Adjudged cases are cited as in support of this position. We have examined these cases, and while such transactions were condemned in the instances then under consideration, we do not understand it is to be deduced from them that it is a fixed rule of law that the formation of a corporation by a debtor, and the conveyance of all his property to the corporation, though made in actual good faith, is conclusively presumed to be fraudulent as a matter of law."

5. The opinion of the Circuit Court of Appeals presumably rejected the theory of the petitioner that a *constructive* delivery of the securities to her took place long prior to May 22, 1934 (on which date she admitted obtaining *physical* possession thereof), on the ground that the income or dividends derived therefrom prior to said date were collected by her husband (R. 180-181). In adopting this view the opinion conflicts with the principles as laid down by the Circuit Court of Appeals in *Anderson* v. *Hultberg*, 247 Fed. 273 (above cited on another point), and *Epstein* v. *Goldstein*, 107 Fed (2) 755.

In the *Anderson* case it was said (Page 283):

> "Finally, did Anderson place the title to the farms in the name of his wife, and did she receive and hold it, not for her benefit but for his, and has he ever since been the real owner thereof?
>
> "* * * But Mrs. Anderson was not a business woman when she was married; the fact that her husband, who is accustomed to business transactions, collects the rents or income of his wife's property, does not convert it into his property or charge it with any trust in his favor. On the other hand such a transaction charges the funds he collects with a trust in her favor, and if he converts them to his own use, renders him her debtor to the amount that he then converts."

And in the *Epstein* case, where the bona fides of the delivery of property to the wife was challenged, the Court said (Page 757):

> "It is urged by the plaintiff that the judgment cannot stand because there is no finding that Mrs. Goldstein received the security 'in good faith' as required by Sections 272 and 273 of the New York Debtor and Creditor Law. But we think this may be spelled out from other findings. Her lack of business experience

and her mental and physical illness in January, 1931, made her incapable of understanding the transaction involved in the transfers. She did not know that they rendered her husband insolvent nor that he was contingently indebted to Northwestern. *Nor can any implication of bad faith be drawn from the fact that she allowed him to manage and control the properties after their transfer as completely as he had done before.*" (Italics ours.)

In the very recent case of *Haskell* v. *Art Institute*, 304 Ill. App. 393, wherein it was sought to set aside a gift of valuable paintings which the wife of the donor (Haskell) charged was in fraud of her marital rights, one of the grounds urged was that there was no valid delivery of the property because the pictures continued to remain in the possession and control of the donor after the alleged gift. The Illinois Appellate Court ruled, however, that the delivery was valid, saying (Page 404):

"Counsel say that since there was no consideration for the pictures * * * and since the paintings remained in the possession of Mr. Haskell, the attempted gift under the statute, is conclusively deemed fraudulent.

"What we have said in reference to the non-applicability of sec. 4 (of the Statute of Frauds) we think applicable to the contention now made. Since we hold that the title to the paintings passed by the two documents of June 17 and June 20 and the paintings remained in Mr. Haskell's apartment and office by virtue of the letter of June 20, for one year, and since in his will he stated the paintings were in his possession by the terms of a certain 'lease,' we think the delivery was sufficient."

(See also *Miller* v. *Silverman*, 247 N. Y. A. 447, 160 N. E. 910.)

6. Assuming the Circuit Court of Appeals was right in reversing the decree dismissing the Complaint, it should have remanded the cause for re-trial to afford the petitioner the opportunity of presenting her defense. Petitioner believes that a reasonable construction of Rule 41(b) of the Rules of Civil Procedure for the District Courts of the United States required this. To interpret the rule otherwise would virtually nullify the right of a defendant to move for a dismissal of a Complaint at the close of a plaintiff's evidence if it were fraught with the danger of being forever barred from interposing a defense after a reviewing court had held that the motion should have been denied instead of allowed. Moreover, the barring of such defense is a denial of "due process," guaranteed by the Federal Constitution.

The precise question here presented has not been passed upon by the Federal Courts, and is of sufficient importance to be decided by this Honorable Court.

Respectfully submitted,

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